

UNITED STATES BANKRUPTCY COURT  
SOUTHERN DISTRICT OF INDIANA  
INDIANAPOLIS DIVISION

IN RE: )  
 )  
ITT EDUCATIONAL SERVICES, INC., *et al.*<sup>1</sup> ) Case No. 16-07207-JMC-7A  
 )  
Debtors. ) Jointly Administered

**TRUSTEE’S MOTION TO COMPROMISE AND SETTLE CERTAIN CLAIMS  
WITH THE DEPARTMENT OF THE TREASURY – INTERNAL REVENUE SERVICE**

Deborah J. Caruso, the chapter 7 trustee in this case (the “Trustee”), by counsel, requests, pursuant to 11 U.S.C. §§ 105(a) and 363 and Rule 9019 of the Federal Rules of Bankruptcy Procedure, approving the terms of a proposed settlement by and between the Trustee, not individually but solely in her capacity as the chapter 7 trustee for, and acting for and on behalf of the Affiliated Debtors (as defined below), and each of the Affiliated Debtors’ respective bankruptcy estates, on the one hand, and the Department of the Treasury – Internal Revenue Service (the “IRS”), on the other hand, regarding appeals associated with audits of the Affiliated Debtors’ consolidated federal income tax returns for 2010, 2011 and 2012 on the following grounds:

**I. JURISDICTION**

1. The Court has jurisdiction over this motion pursuant to 28 U.S.C. §§ 157 and 1334. This matter is a core proceeding within the meaning of 28 U.S.C. § 157(b).
2. Venue is proper in this district pursuant to 28 U.S.C. §§ 1408 and 1409.
3. The statutory predicates for relief are sections 105 and 363 of the United States Code (the “Bankruptcy Code”) and Rule 9019 of the Federal Rules of Bankruptcy Procedure (the “Bankruptcy Rules”).

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<sup>1</sup> The debtors in these cases, along with the last four digits of their respective federal tax identification numbers are ITT Educational Services, Inc. [1311]; ESI Service Corp. [2117]; and Daniel Webster College, Inc. [5980].

## **II. BACKGROUND**

4. On September 16, 2016 (the “Petition Date”), ITT Educational Services, Inc. (“ITT”), ESI Service Corp. (“ESI”) and Daniel Webster College, Inc. (“DWC,” and together with ITT and ESI, the “Affiliated Debtors”) filed voluntary petitions for relief under chapter 7 of the Bankruptcy Code. The Trustee was appointed interim trustee under section 701 of the Bankruptcy Code in each of the Affiliated Debtors’ bankruptcy cases on the Petition Date, and in accordance with section 702(d) of the Bankruptcy Code, became the permanent case trustee on November 1, 2016 following the conclusion of the meeting of creditors held pursuant to section 341(a) of the Bankruptcy Code.

5. On October 4, 2016, the Court entered its *Order Granting Motion for Joint Administration of Chapter 7 Cases* [Docs 221 & 222], directing the Affiliated Debtors’ bankruptcy cases to be jointly administered for procedural purposes only.

6. In or about January 2010, ITT entered into agreements with PEAKS Trust-2009, a Delaware Statutory Trust (the “Trust”) and certain other entities to create the PEAKS Loan Program. Under the PEAKS Loan Program, the Trust raised \$300,000,000 from institutional investors in exchange for 10-year notes and used the proceeds to purchase loans made by an originating bank (the “Bank”) to ITT students to pay tuition and fees owed to ITT. The Bank distributed the proceeds of the student loans to ITT for the account of the students, but under the PEAKS Loan Program, ITT was required to return 28% of those proceeds to the Trust in exchange for a subordinated promissory note due in 2026 (the “Subordinated Note”).

7. ITT discounted the Subordinated Note to present value using a 9% interest rate and claimed deductions for the discount totaling \$58,339,624 on the Affiliated Debtors’ consolidated federal income tax returns for 2010 and 2011. ITT also reported interest income in

2010, 2011, and 2012 from amortization of the \$58,339,624 amount as original issue discount (“OID”) over the term of the Subordinated Note.

8. The IRS audited the Affiliated Debtors’ consolidated federal income tax returns for 2010, 2011, and 2012, and in 2013 proposed to disallow the deductions claimed with respect to the Subordinated Note in 2010 and 2011, as well as a property tax deduction of \$1,075,187 for 2011. The IRS also proposed to decrease ITT’s taxable income for 2010, 2011, and 2012 by the OID ITT reported as interest income for those years. The net results of all these proposed adjustments would have been a net increase in total tax liability for 2010 through 2012 of approximately \$18,292,065, exclusive of interest and penalties.

9. ITT filed a protest and appeal of the proposed adjustments with the IRS Appeals Office, where the matter was still pending on the Petition Date.

### **III. COMPROMISE AND SETTLEMENT**

10. Following the Petition Date, the Trustee engaged in settlement discussions with the IRS Appeals Office regarding the resolution of the proposed adjustments. Such discussions have resulted in a proposed compromise and settlement that has been memorialized in the *Offer to Waive Restrictions on Assessment and Collection of Tax Deficiency and to Accept Overassessment* (the “Offer”) attached to this motion as Exhibit 1.

11. Under the Offer, the Trustee, on behalf of the Affiliated Debtors, will agree to all of the adjustments to taxable income originally proposed in 2013 by the IRS for 2010, 2011, and 2012, and the IRS will agree, subject to approval by the IRS Commissioner, to allow a bad debt deduction in 2012 of \$49,588,680 with respect to the Subordinated Note and a net operating loss deduction in 2012 of \$52,058,304 for carryback of a net operating loss from 2014. If this proposed compromise and settlement is approved by the Court and the IRS Commissioner, the Affiliated Debtors will owe additional tax for 2010, 2011, and 2012 of \$936,028, plus applicable

interest and penalties, as compared with the \$18,292,065 of additional tax, exclusive of interest and penalties, that would have been owed under the adjustments originally proposed by the IRS in 2013.

12. The Affiliated Debtors are due a refund from the IRS of approximately \$8,644,105 for the 2015 tax year (the “2015 Refund”), due to carryback of a 2016 net operating loss to 2015. Although the 2015 Refund had been approved by the IRS and by the Joint Committee on Taxation (*see* 26 U.S.C. § 6405), the IRS has not yet paid the 2015 Refund to the Affiliated Debtors’ bankruptcy estates, pending resolution of the audit for 2010, 2011, and 2012.

13. Section 6402(a) of the Internal Revenue Code, 26 U.S.C. § 6402(a), authorizes the IRS to apply any overpayment of tax against other outstanding tax liabilities of the same person. In addition, section 362(b)(26) of the Bankruptcy Code provides an exception to the automatic stay for “the setoff under applicable nonbankruptcy law of an income tax refund, by a governmental unit, with respect to a taxable period that ended before the date of the order for relief against an income tax liability for a taxable period that also ended before the date of the order for relief . . . .” Accordingly, the Trustee expects that if the Offer is approved by the Court and the IRS Commissioner, the IRS will set off a portion of the 2015 Refund sufficient to pay the additional tax, plus applicable interest and penalties, due for the 2010, 2011, and 2012 tax years, and pay the remaining balance of the 2015 Refund to the Affiliated Debtors’ bankruptcy estates. The Trustee’s accountants have reported that the IRS has tentatively estimated that the net refund to the bankruptcy estates after the setoff will be approximately \$6.8 million.

### **III. RELIEF REQUESTED**

14. The Trustee requests entry of an order, pursuant to sections 105(a) and 363 of the Bankruptcy Code and Bankruptcy Rule 9019, (a) approving the Offer, and (b) authorizing the Trustee to enter into the Offer, which remains subject to approval by the IRS Commissioner.

#### **IV. GROUNDS FOR GRANTING RELIEF**

15. A court may authorize a trustee to enter into a settlement so long as it is a sound exercise of the trustee's business judgment. *See* 11 U.S.C. § 363(b); *In re UAL Corp.*, 443 F.3d 565, 571 (7th Cir. 2006) (use under section 363 of the Bankruptcy Code must "[make] good business sense"); *In re Schipper*, 933 F.2d 513, 515 (7th Cir. 1991) (section 363 involves exercise of fiduciary duties and requires an "articulated business justification"); *see also In re Olde Prairie Block Owners, LLC*, 448 B.R. 482, 492 (Bankr. N.D. Ill. 2011) (same). Moreover, when applying the "business judgment" standard to a use of estate property under section 363 of the Bankruptcy Code, a trustee's judgment is "entitled to great judicial deference as long as a sound business reason is given." *See In re Efoora, Inc.*, 472 B.R. 481, 488 (Bankr. N.D. Ill. 2012).

16. Similarly, Bankruptcy Rule 9019(a) sets forth the requirements for compromises and settlements and permits a bankruptcy court to approve a trustee's "compromise or settlement" after notice and a hearing, if such settlement is "fair and equitable . . . and in the best interests of the bankruptcy estate." *Depoister v. Mary M. Holloway Found.*, 36 F.3d 582, 586 (7th Cir. 1994); *see also In re Energy Co-op., Inc.*, 886 F.2d 921, 927 (7th Cir. 1989) ("The benchmark for determining the propriety of a bankruptcy settlement is whether the settlement is in the best interest of the estate."); *In re Smith*, No 02-16450-JKC-7A, 2008 Bankr. LEXIS 2821, \*6 (Bankr. S.D. Ind. Sept. 10, 2008) (same). Settlements should be approved unless "the settlement 'falls below the lowest point in the range of reasonableness.'" *In re Commercial Loan Corp.*, 316 B.R. 690, 698 (Bankr. N.D. Ill. 2004) (quoting *Energy Co-op.*, 886 F.2d at 929); *In re Doctors Hosp. of Hyde Park, Inc.*, 474 F.3d 421, 426 (7th Cir. 2007); *see also In re Artra Grp., Inc.*, 300 B.R. 699, 702 (Bankr. N.D. Ill. 2003). Settlements and compromises are favored in bankruptcy because they expedite case administration and reduce unnecessary administrative

costs. *Fogel v. Zell*, 221 F.3d 955, 960 (7th Cir. 2000). In determining whether a compromise is in the best interests of the estate, the Court must compare “the settlement’s terms with the litigation’s probable costs and probable benefits.” *In re Am. Reserve Corp.*, 841 F.2d 159, 161 (7th Cir. 1987); *see also Doctors Hosp.*, 474 F.3d at 426 (“Among the factors the court considers are the litigation’s probability of success, complexity, expense, inconvenience, and delay, including the possibility that disapproving the settlement will cause wasting of assets.” (internal quotation marks and citations omitted); *Commercial Loan*, 316 B.R. at 697 (holding that relevant factors a bankruptcy court should consider in approving a settlement include “the litigation’s probability of success, its complexity, and its ‘attendant expense, inconvenience and delay’” (quoting *Am. Reserve Corp.*, 841 F.2d at 161)).

17. Here, the proposed compromise and settlement memorialized in the Offer provides for a resolution of the disputed audits of the Affiliated Debtors’ consolidated federal income tax returns for 2010, 2011 and 2012, resulting in reduced tax liability of \$936,028, plus applicable interest and penalties, as compared to the original tax liability of \$18,292,065, exclusive of applicable interest and penalties, proposed by the IRS in 2013. The Offer also allows for the resolution of the previously approved 2015 Refund that has not yet been paid to the Affiliated Debtors, pending resolution of the audit for 2010, 2011 and 2012.

18. For the foregoing reasons, the Trustee has determined, in the exercise of her sound business judgment, that the Offer is fair, equitable, in the best interest of the Affiliated Debtors’ bankruptcy estates, and well within the range of reasonableness for approval under Bankruptcy Rule 9019(a). Accordingly, the Trustee submits that the Court should approve the Offer and authorize the Trustee to enter into the Offer, which remains subject to approval by the IRS Commissioner.

## **V. NOTICE**

19. Pursuant to the *Notice, Case Management and Administrative Procedures* (the “Case Management Procedures”) approved by the Court on October 4, 2016 [Doc 220], the Trustee will serve a copy of this motion, including the exhibits, on the following (as defined in the Case Management Procedures): (a) the Core Group; (b) the Request for Notice List; and (c) the Appearance List.

**NOTICE IS GIVEN**, that pursuant to the Case Management Procedures, any objection to this motion must be in writing and filed with the Bankruptcy Clerk by no later than **4:00 p.m.** (prevailing Eastern time) on **August 14, 2019**. Those not required or not permitted to file electronically must deliver any objection by U.S. mail, courier, overnight/express mail or in person at:

116 U.S. Courthouse  
46 East Ohio Street  
Indianapolis, IN 46204

The objecting party must also serve a copy of the written objection upon the Trustee’s counsel, at Counsel for Trustee Deborah J. Caruso, Rubin & Levin, P.C., 135 N. Pennsylvania Street, Suite 1400, Indianapolis, IN 46204. **If an objection is NOT timely filed, the requested relief may be granted without a hearing.**

**NOTICE IS FURTHER GIVEN** that in the event an objection to this motion is timely filed, a hearing on this motion and such objection will be conducted on **August 21, 2019** at **1:30 p.m.** (prevailing Eastern time), in Room 325 of the United States Courthouse, 46 East Ohio Street, Indianapolis, IN 46204.

**WHEREFORE**, the Trustee respectfully requests entry of an order: (i) approving the Offer; (ii) authorizing the Trustee to enter into the Offer, which remains subject to approval by the IRS Commissioner; and (iii) granting the Trustee all other just and proper relief.

Respectfully submitted,

RUBIN & LEVIN, P.C.

By: /s/ Meredith R. Theisen

Meredith R. Theisen

Deborah J. Caruso (Atty. No. 4273-49)

John C. Hoard (Atty. No. 8024-49)

Meredith R. Theisen (Atty. No. 28804-49)

RUBIN & LEVIN, P.C.

135 N. Pennsylvania Street, Suite 1400

Indianapolis, Indiana 46204

Tel: (317) 634-0300

Fax: (317) 263-9411

Email: dcaruso@rubin-levin.net

johnh@rubin-levin.net

mtheisen@rubin-levin.net

Attorneys for Deborah J. Caruso, Trustee

### **CERTIFICATE OF SERVICE**

I hereby certify that on August 1, 2019, a copy of the foregoing *Trustee's Motion to Compromise and Settle Certain Claims with the Department of the Treasury – Internal Revenue Service* was filed electronically. Pursuant to Section IV.C.3(a) of the Case Management Procedures, notice of this filing will be sent to the following parties through the Court's Electronic Case Filing System. Parties may access this filing through the Court's system.

John Joseph Allman jallman@hbkfirm.com, dadams@hbkfirm.com

Richard Allyn rallyn@robinskaplan.com

Robert N Amkraut ramkraut@foxrothschild.com

Scott S. Anders scott.anders@jordanramis.com, litparalegal@jordanramis.com

Manuel German Arreaza manuel.arreaza@cfpb.gov

Todd Allan Atkinson tatkinson@ulmer.com

Kay Dee Baird kbaird@kdlegal.com, rhobdy@kdlegal.com; crbpgpleadings@kdlegal.com

Michael I. Baird baird.michael@pbgc.gov, efile@pbgc.gov

Christopher E. Baker cbaker@hbkfirm.com, thignight@hbkfirm.com

James David Ballinger jim@kentuckytrial.com, jennifer@kentuckytrial.com

Joseph E. Bant jebant@lewisricekc.com

William J. Barrett william.barrett@bfkn.com, mark.mackowiak@bfkn.com

Ashley Flynn Bartram ashley.bartram@oag.texas.gov

Alex M Beeman alex@beemanlawoffice.com, abeeman@reminger.com

Thomas M Beeman tom@beemanlawoffice.com

Richard James Bernard rbernard@foley.com

Thomas Berndt tberndt@robinskaplan.com, jgerboth@robinskaplan.com

John J Berry john.berry@dinsmore.com, Christina.Lee@DINSMORE.COM

Lauren Beslow lauren.beslow@quarles.com

Brandon Craig Bickle bbickle@gablelaw.com



Jill B. Bienstock jbienstock@coleschotz.com  
Michael Blumenthal michael.blumenthal@tklaw.com  
David J. Bodle dbodle@hhclaw.com, layres@hhlaw-in.com  
Robert A. Breidenbach rab@goldsteinpressman.com  
Wendy D Brewer wbrewer@fmdlegal.com, cbellner@fmdlegal.com  
Kayla D. Britton kayla.britton@faegrebd.com, noticeFRindy@faegrebd.com  
Robert Bernard Bruner bob.bruner@nortonrosefulbright.com  
Jason R Burke jburke@bbrlawpc.com, kellis@bbrlawpc.com  
Erin Busch ebusch@nebraska.edu  
John Cannizzaro john.cannizzaro@icemiller.com, Thyrza.Skofield@icemiller.com  
Kevin M. Capuzzi kcapuzzi@beneschlaw.com,  
lmolinaro@beneschlaw.com;docket@beneschlaw.com  
James E. Carlberg jcarlberg@boselaw.com,  
mwakefield@boselaw.com;rmurphy@boselaw.com  
Steven Dean Carpenter scarpenter1@dor.in.gov  
Deborah Caruso dcaruso@rubin-levin.net, dwright@rubin-levin.net;jkrichbaum@rubin-  
levin.net;atty\_dcaruso@bluestylus.com  
Deborah J. Caruso trustee caruso@rubin-levin.net, DJC@trustesolutions.net  
Joshua W. Casselman jcasselman@rubin-levin.net, angie@rubin-  
levin.net;atty\_jcasselman@bluestylus.com  
Ben T. Caughey ben.caughey@merchocaughey.com  
Sonia A. Chae chaes@sec.gov  
John Andrew Chanin jchanin@lindquist.com, srummery@lindquist.com  
Courtney Elaine Chilcote courtney@ckhatterneys.com,  
ckh@ckhatterneys.com;tracy@ckhatterneys.com  
Dale C Christensen christensen@sewkis.com  
Eboney Delane Cobb ecobb@pbfc.com  
Tiffany Cobb tscobb@vorys.com  
Michael Edward Collins mcollins@manierherod.com  
Michael Anthony Collyard mcollyard@robinskaplan.com, rhoule@robinskaplan.com  
Eileen Connor econnor@law.harvard.edu  
Lawrence D. Coppel lcoppel@gfrlaw.com  
Heather M. Crockett Heather.Crockett@atg.in.gov, darlene.greenley@atg.in.gov  
J Russell Cunningham rcunningham@dnlc.net, reaster@dnlc.net  
Erica Dausch edausch@babstcalland.com  
Melissa J. DeGroff mjd@kgrlaw.com, cjs@kgrlaw.com  
Dustin R. DeNeal dustin.deneal@faegrebd.com, noticeFRindy@faegrebd.com  
Laura A DuVall Laura.Duvall@usdoj.gov, Catherine.henderson@usdoj.gov  
Annette England annette.england@btlaw.com  
Charles Anthony Ercole cercole@klehr.com, acollazo@klehr.com  
Carolyn Meredith Fast carolyn.fast@ag.ny.gov  
Elaine Victoria Fenna elaine.fenna@morganlewis.com  
Andrew W Ferich awf@chimicles.com  
Scott Patrick Fisher sfisher@drewrysimmons.com, lgarrison@DSVlaw.com  
John David Folds dfolds@bakerdonelson.com, sparson@bakerdonelson.com  
Jennifer N Fountain jfountain@iislaw.com, sfilippini@iislaw.com  
Sarah Lynn Fowler sarah.fowler@mbcblaw.com, deidre.gastenveld@mbcblaw.com

Robert W. Fuller    rfuller@rbh.com  
Carlos Galliani    carlos@thelidjifirm.com  
Jonathan William Garlough    jgarlough@foley.com, mstockl@foley.com;mdlee@foley.com  
Lisa Giandomenico    lgiandomenico@nmag.gov  
Lea Pauley Goff    lea.goff@skofirm.com, emily.keith@skofirm.com  
John C Goodchild    john.goodchild@morganlewis.com  
Douglas Gooding    dgooding@choate.com  
John Andrew Goodridge    jagoodridge@jaglo.com, angray@jaglo.com;dwhiggs@jaglo.com  
Michael Wayne Grant    michael.w.grant@doj.state.or.us  
Richard Grayson Grant    rgrant@rgglaw.com, grantecf@gmail.com  
Alan Mark Grochal    agrochal@tydingslaw.com  
Elizabeth N. Hahn    ehahn@rubin-levin.net, mralph@rubin-levin.net  
Gregory Forrest Hahn    ghahn@boselaw.com, jmcneeley@boselaw.com  
Julian Ari Hammond    jhammond@hammondlawpc.com, ppecherskaya@hammondlawpc.com  
Wallace M Handler    whandler@swappc.com, kkloock@swappc.com  
William J. Hanlon    whanlon@seyfarth.com  
Adam Craig Harris    adam.harris@srz.com  
Brian Hauck    bhauck@jenner.com  
Jeffrey M. Hawkinson    jhawkinson@pcslegal.com, danderson@pcslegal.com  
Michael J. Hebenstreit    mjh@whzlaw.com,  
arlene@whzlaw.com;ene@whzlaw.com;kdt@whzlaw.com  
Amanda Marie Hendren    amanda@indianalawgroup.com  
Claude Michael Higgins    Michael.Higgins@ag.ny.gov  
Michael W. Hile    mhile@jacobsonhile.com, assistant@jacobsonhile.com  
Sean M Hirschten    shirschten@psrb.com  
Robert M. Hirsh    robert.hirsh@arentfox.com  
John C. Hoard    johnh@rubin-levin.net, jkrichbaum@rubin-  
levin.net;atty\_jch@trustesolutions.com;sturpin@rubin-levin.net  
Curt Derek Hochbein    chochbein@rubin-levin.net, mralph@rubin-levin.net;lking@rubin-  
levin.net;atty\_chochbein@bluestylus.com;robin@rubin-levin.net  
Jeffrey A Hokanson    jeff.hokanson@icemiller.com, bgnotices@icemiller.com  
Steven Howard Holinstat    sholinstat@proskauer.com  
Diana Hooley    diana.hooley@state.ma.us  
Thomas Ross Hooper    hooper@sewkis.com  
George Wade Hopper    ghopper@cohenandmalad.com, klandeck@cohenandmalad.com  
Andrew E. Houha    bkecfnotices@johnsonblumberg.com  
Andrew W. Hull    awhull@hooverhullturner.com, fgipson@hooverhullturner.com  
James C Jacobsen    jjacobsen@nmag.gov, eheltman@nmag.gov  
Christine K. Jacobson    cjacobson@jacobsonhile.com, 5412@notices.nextchapterbk.com  
Jay Jaffe    jay.jaffe@faegrebd.com, noticeFRindy@faegrebd.com  
David Januszewski    djanuszewski@cahill.com  
Benjamin F Johns    bfj@chimicles.com, klw@chimicles.com  
Russell Ray Johnson    russj4478@aol.com  
Kenneth C. Jones    kcjones@lewisricekc.com  
Anthony R. Jost    tjost@rbelaw.com, baldous@rbelaw.com  
David J. Jurkiewicz    DJurkiewicz@boselaw.com,  
mwakefield@boselaw.com;rmurphy@boselaw.com;dlingenfelter@boselaw.com

Aaron Kappler akappler@tokn.com  
Timothy Q. Karcher tkarcher@proskauer.com  
Steven Joseph Kasyjanski sjk-yount-atty@ameritech.net, skasyjan@gmail.com  
Alan Katz akatz@lockelord.com  
Richard B. Kaufman richardkfmn@gmail.com  
Carly Kessler ckessler@robinskaplan.com  
John M. Ketcham jketcham@psrb.com, scox@psrb.com  
Taejin Kim tae.kim@srz.com  
Edward M King tking@fbtlaw.com, lsugg@fbtlaw.com;tking@ecf.inforuptcy.com  
Roy F. Kiplinger bankruptcy@kiplingerlaw.com, bankruptcy@kiplingerlaw.com  
Jackson Taylor Kirklin taylor.kirklin@usdoj.gov, melanie.crouch@usdoj.gov  
James A. Knauer jak@kgrlaw.com, tjf@kgrlaw.com  
Kevin Dale Koons kkoons@kgrlaw.com  
Harris J. Koroglu hkoroglu@shutts.com, fsantelices@shutts.com  
Lawrence Joel Kotler ljkotler@duanemorris.com  
Robert R Kracht rrk@mccarthylebit.com  
Andrew L. Kraemer akraemer@johnsonblumberg.com, akraemerlawoffice@att.net  
David R. Krebs dkrebs@hbkfirm.com, dadams@hbkfirm.com  
Jerrold Scott Kulback jkulback@archerlaw.com  
Jay R LaBarge jlabarge@stroblpc.com  
Darryl S Laddin bkrfilings@agg.com  
Michael J. Langlois mlanglois@shouselanglois.com, rshouse@shouselanglois.com  
Vilda Samuel Laurin slaurin@boselaw.com  
Jordan A Lavinsky jlavinsky@hansonbridgett.com  
Todd Evan Leatherman todd.leatherman@ky.gov  
David S Lefere dlefer@mikameyers.com, jfortney@mikameyers.com  
Anthony Darrell Lehman alehman@hbwlegal.com  
Martha R. Lehman mlehman@salawus.com,  
marthalehman87@gmail.com;pdidandeh@salawus.com;lengle@salawus.com  
Gary H Leibowitz gleibowitz@coleschotz.com,  
pratkowiak@coleschotz.com;gleibowitz@coleschotz.com  
Donald D Levenhagen dlevenhagen@landmanbeatty.com  
Elizabeth Marie Little elizabeth.little@faegrebd.com  
Edward J LoBello elobello@msek.com  
Melinda Hoover MacAnally Melinda.MacAnally@atg.in.gov,  
Carrie.Spann@atg.in.gov;Kenyatta.Perman@atg.in.gov  
Christopher John Madaio Cmadaio@oag.state.md.us  
John A. Majors jam@morganandpottinger.com, majormajors44@yahoo.com  
Steven A. Malcoun dsmith@mayallaw.com  
Jonathan Marshall jmarshall@choate.com  
Thomas Marvin Martin tmmartin@lewisricekc.com  
Jeff J. Marwil jmarwil@proskauer.com,  
npetrov@proskauer.com;pyoung@proskauer.com;sholinstat@proskauer.com  
Richard J Mason rmason@mcguirewoods.com  
C. Ed Massey mbracken@nkylawyers.com, cedmassey@nkylawyers.com  
Ann Wilkinson Matthews amatthews@ncdoj.gov  
Rachel Jaffe Mauceri rachel.mauceri@morganlewis.com

Michael Wesley McBride mmcbride@cohenandmalad.com, klandeck@cohenandmalad.com  
Michael K. McCrory mmccrory@btlaw.com, bankruptcyindy@btlaw.com  
Maureen Elin McOwen molly.mcowen@cfpb.gov  
Harley K Means hkm@kgrlaw.com, kwhigham@kgrlaw.com;cjs@kgrlaw.com  
Toby Merrill tomerrill@law.harvard.edu, ppsl@law.harvard.edu  
Robert W. Miller rmiller@manierherod.com  
Sherry Millman smillman@stroock.com  
Jason Milstone jason.milstone@cmsenergy.com  
Thomas E Mixdorf thomas.mixdorf@icemiller.com, brandy.matney@icemiller.com  
Evgeny Grigori Mogilevsky eugene@egmlegal.com,  
emily@egmlegal.com;mogilevskyer41855@notify.bestcase.com  
James P Moloy jmoloy@boselaw.com,  
dlingenfelter@boselaw.com;mwakefield@boselaw.com  
Ronald J. Moore Ronald.Moore@usdoj.gov  
Hal F Morris hal.morris@oag.texas.gov  
Michael David Morris michael.morris@ago.mo.gov  
Kevin Alonzo Morrissey kmorrissey@lewis-kappes.com, soliver@lewis-  
kappes.com;leckert@lewis-kappes.com;kwilliams@lewis-kappes.com  
Whitney L Mosby wmosby@bgdlegal.com, fwolfe@bgdlegal.com  
C Daniel Motsinger cmotsinger@kdlegal.com,  
cmotsinger@kdlegal.com;crbpgpleadings@kdlegal.com;shammersley@kdlegal.com  
Lee Duck Moylan lmoylan@klehr.com, acollazo@klehr.com  
Joseph L. Mulvey joseph@mulveyllc.com, linda@mulveyllc.com  
Abraham Murphy murphy@abrahammurphy.com  
Justin Scott Murray jmurray@atg.state.il.us  
Alissa M. Nann anann@foley.com, DHeffer@foley.com  
Henry Seiji Newman hsnewman@dglaw.com  
Kevin M. Newman knewman@menterlaw.com, kmnbk@barclaydamon.com,kevin-newman-  
8809@ecf.pacerpro.com  
Cassandra A. Nielsen cnielsen@rubin-levin.net,  
atty\_cnielsen@bluestylus.com,mralph@rubin-levin.net;lking@rubin-levin.net  
Ryan Charles Nixon rcnixon@lamarcalawgroup.com  
Isaac Nutovic inutovic@nutovic.com  
Michael O'Donnell mike.odonnell@nortonrosefulbright.com  
Gregory Ostendorf gostendorf@scopelitis.com, agregory@scopelitis.com  
Weston Erick Overturf wes.overturf@mbcblaw.com,  
deidre.gastenveld@mbcblaw.com;ellen.sauter@mbcblaw.com  
Pamela A. Paige ppaige@plunkettcooney.com, amiller@plunkettcooney.com  
Kenneth Pasquale kpasquale@stroock.com  
Eric Pendergraft ependergraft@slp.law, dwoodall@slp.law;bss@slp.law  
Danielle Ann Pham danielle.pham@usdoj.gov  
Anthony Pirraglia anthony.pirraglia@tklaw.com  
Jack A Raisner jar@outtengolden.com,  
kdeleon@outtengolden.com;jquinonez@outtengolden.com  
Jonathan Hjalmer Reischl jonathan.reischl@cfpb.gov  
Michael Rella mrella@mmlawus.com  
Caroline Ellona Richardson caroline@paganelligroup.com, anna@paganelligroup.com

James Leigh Richmond James.Richmond@fldoe.org  
Mai Lan Gabrielle Rodgers Rodgers.MaiLan@pbgc.gov, efile@pbgc.gov  
John M. Rogers johnr@rubin-levin.net, jkrichbaum@rubin-levin.net;atty\_rogers@bluestylus.com;mralf@rubin-levin.net;lking@rubin-levin.net  
Melissa M. Root mroot@jenner.com, wwilliams@jenner.com  
David A. Rosenthal darlaw@nlci.com  
James E Rossow jim@rubin-levin.net, ATTY\_JER@trustesolutions.com;robin@rubin-levin.net  
Rene Sara Roupinian rsr@outtengolden.com,  
jxh@outtengolden.com;kdeleon@outtengolden.com;rfisher@outtengolden.com;gl@outtengolden.com;jquinonez@outtengolden.com;tloughran@outtengolden.com  
Victoria Fay Roytenberg vroytenberg@law.harvard.edu, jjimenez@law.harvard.edu  
Steven Eric Runyan ser@kgrlaw.com  
Craig Damon Rust craig.rust@doj.ca.gov, Lindsay.Bensen@doj.ca.gov  
Karl T Ryan info@ryanesq.com, kryan@ryanesq.com  
Joseph Michael Sanders jsanders@atg.state.il.us  
Thomas C Scherer tscherer@bgdlegal.com, fwolfe@bgdlegal.com  
James R. Schrier jrs@rtslawfirm.com, lrobison@rtslawfirm.com;jlandes@rtslawfirm.com  
Ronald James Schutz rschutz@robinskaplan.com  
H. Jeffrey Schwartz jschwartz@robinskaplan.com  
Courtney Michelle Scott cscott1@dor.in.gov  
Joseph E Shickich jshickich@foxrothschild.com, vmagda@foxrothschild.com  
Randall R Shouse rshouse@shouselanglois.com, mlanglois@shouselanglois.com  
William E Smith wsmith@k-glaw.com, clipke@k-glaw.com  
Lauren C. Sorrell lsorrell@kdlegal.com,  
ayeskie@kdlegal.com;swaddell@kdlegal.com;cmotsinger@kdlegal.com;shammersley@kdlegal.com  
Berry Dan Spears berrydspears616@gmail.com  
Catherine L. Steege csteege@jenner.com,  
mhinds@jenner.com;thooker@jenner.com;aswingle@jenner.com  
LaChelle D Stepp lstepp@steppjaffe.com, lastepp@yahoo.com  
Jason V Stitt jstitt@kmklaw.com  
Sharon Stolte sstolte@sandbergphoenix.com  
Jesse Ellsworth Summers esummers@burr.com, sguest@burr.com  
Matthew G. Summers summersm@ballardspahr.com, lanoc@ballardspahr.com  
Jonathan David Sundheimer jsundheimer@btlaw.com  
Nathan L Swehla nswehla@graydon.law  
Nancy K. Swift nswift@buchalter.com, cbohnsack@buchalter.com  
Andrew W.J. Tarr atarr@robinsonbradshaw.com, jrobey@robinsonbradshaw.com  
Eric Jay Taube eric.taube@wallerlaw.com,  
annmarie.jezisek@wallerlaw.com;sherri.savala@wallerlaw.com  
Meredith R. Theisen mtheisen@rubin-levin.net, dwright@rubin-levin.net;mcruser@rubin-levin.net  
Meredith R. Theisen mtheisen@rubin-levin.net,  
atty\_mtheisen@bluestylus.com;mralf@rubin-levin.net  
Jessica L Titler jt@chimicles.com  
David Tocco dtocco@vorys.com, mdwalkuski@vorys.com

Todd Christian Toral todd.toral@dlapiper.com, todd-toral-9280@ecf.pacerpro.com  
Ronald M. Tucker rtucker@simon.com, cmartin@simon.com, bankruptcy@simon.com  
Christopher Turner christopher.turner@lw.com, DCItiserv@lw.com  
U.S. Trustee ustpregion10.in.ecf@usdoj.gov  
Michael Ungar MUngar@mwe.com  
Lauren Valkenaar lauren.valkenaar@nortonrosefulbright.com  
Sally E Veghte sveghte@klehr.com, acollazo@klehr.com  
Rachel Claire Verbeke rverbeke@stroblpc.com  
Aimee Vidaurri aimee.vidaurri@nortonrosefulbright.com  
Amy L VonDielingen avondielingen@woodmclaw.com  
Amy E Vulpio vulpioa@whiteandwilliams.com  
Carolyn Graff Wade Carolyn.G.Wade@doj.state.or.us  
Christopher D Wagner cwagner@hooverhullturner.com  
Louis Hanner Watson louis@watsonnorris.com  
Jeffrey R. Waxman jwaxman@morrisjames.com,  
jdawson@morrisjames.com;wweller@morrisjames.com  
Philip A. Whistler philip.whistler@icemiller.com, holly.minnis@icemiller.com  
Bradley Winston bwinston@winstonlaw.com, lwheaton@winstonlaw.com  
Brandon Michael Wise bwise@prwlegal.com  
Cathleen Dianne Wyatt cwyatt@fbtlaw.com, tacton@fbtlaw.com  
James T Young james@rubin-levin.net, lking@rubin-levin.net;atty\_young@bluestylus.com  
James E. Zoccola jzoccola@lewis-kappes.com

I further certify that on August 1, 2019, pursuant to Section IV.C.3(c) of the Case Management Procedures, a copy of the foregoing *Trustee's Motion to Compromise and Settle Certain Claims with the Department of the Treasury – Internal Revenue Service* was emailed to the following:

Arlington ISD/Richardson ISD: Eboney Cobb at ecobb@pbfc.com  
CEC Red Run, LLC: Alan M. Grochal at agrochal@tydingslaw.com  
SWRE Deal V Building, LLC: Paul Weiser at pweiser@buchalter.com  
Tarrant County/Dallas County: Elizabeth Weller at dallas.bankruptcy@publicans.com  
Northwest Natural Gas Company: Ashlee Minty at Ashlee.Minty@nwnatural.com  
Solar Drive Business, LLC: Chris W. Halling at challing@hallingmeza.com  
Market-Turk Company: Jordan A. Lavinsky at jlavinsky@hansonbridgett.com  
Taxing Authority for Harris County, Texas: John P. Dillman at houston\_bankruptcy@lgbs.com  
Texas Comptroller of Public Accounts: Rachel Obaldo at rachel.obaldo@oag.texas.gov  
Clear Creek Independent School District: Carl O. Sandin at csandin@pbfc.com  
Synchrony Bank: Recovery Management Systems Corporation at claims@recoverycorp.com  
Bexar County: Don Stecker at sanantonio.bankruptcy@publicans.com  
SWRE Deal V Building, LLC: Nancy K. Swift at nswift@buchalter.com  
TN Dept. of Revenue: Michael Willey at michael.willey@ag.tn.gov  
Florida Department of Education: Benman D. Szeto at benman.szeto@fldoe.org  
Last Second Media, Inc.: T. Todd Eglund at tegland@beldenblaine.com  
Hung Duong: Kevin Schwin at kevin@schwinlaw.com  
Travis County: Kay D. Brock at kay.brock@traviscountytexas.gov  
Able Building Maintenance: Scott D. Fink at bronationalecf@weltman.com



Marathon Ventures, LLC: Daniel M. Karger at kargerlaw@gmail.com  
Oklahoma County Treasurer: Tammy Jones at tammy.jones@oklahomacounty.org  
JM Partners LLC: John Marshall at jmarshall@jmpartnersllc.com

/s/ Meredith R. Theisen

Meredith R. Theisen

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